### **Testimony of:**

## Michael J. Ward, Chairman and CEO

**CSX Corporation** 

on

"Investment in the Rail Industry"

before the

**United States House of Representatives** 

Committee on Transportation and Infrastructure,

**Subcommittee on Railroads, Pipelines, and Hazardous Materials** 

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CSX Corporation 500 Water St. Jacksonville, FL 32202 (904) 359-3100 Chairwoman Brown, Ranking Member Shuster and Members of the Subcommittee:

Thank you for your time today, and for considering CSX Corporation's views on the important subject of investment in the rail industry.

I come to you today as the Chairman and CEO of CSX and as a railroader with more than 30 years of experience. I am committed to creating value for all CSX shareholders. That value is created when CSX meets its public service and common carrier obligations to our customers, our 35,000 employees, the communities where we do business, and you, the policymakers who make the laws that shape our operating environment. When CSX delivers exceptional performance, our customers, our shareholders and our country all benefit.

My testimony will cover three areas: 1) CSX's business, and the service that it provides to our nation; 2) our track record and future plans to meet and exceed the expectations of all of our company's stakeholders; and 3) the harmful implications for our country if railroads were to respond to outside pressures to reduce capital spending and cease investing for the long-term.

#### The Role of Freight Rail and CSX in the American Economy

As you are aware, North America's Class I freight railroads and their outstanding employees are unequalled in terms of operations and safety. They are truly the envy of the world. Their performance helps to strengthen our nation's economy in a safe, secure way that saves fuel and reduces congestion on the roads and highways. According to the Association of American Railroads, full-year 2007 U.S. carloads totaled 16,952,288. Full-year 2007 U.S. intermodal loadings were 12,026,660 trailers and containers. Total volume for the year was estimated at 1.76 trillion ton-miles. Railroads serve as the circulatory system of the U.S. economy, and efficient and reliable rail transportation is one of the genuine competitive advantages that U.S. businesses have in the global economy.

At CSX, we see robust demand and opportunity for freight rail service in the years ahead. As this committee recognized in a hearing held on January 17, 2008, U.S. freight rail movements are expected to increase 92 percent over the next 30 years. To meet the increasing transportation demands of the American economy the rail industry must continue to make significant investments in its infrastructure.

In recent testimony before this Committee, Surface Transportation Board (STB)
Chairman Charles Nottingham noted:

"...in recent years, the U.S. rail network, like other transportation sectors, has become capacity-constrained. On April 11, 2007, the Board held a public hearing focused on rail capacity, traffic forecasts, and infrastructure requirements. At the hearing, we heard a broad consensus that rail capacity will become increasingly constrained by traffic growth. It is clear that the rail system's capacity shortfall that we see in many markets today will dramatically worsen unless bold new policies and strategies are adopted. The energy sector is especially vulnerable to rail capacity constraints and service problems."

As Chairman Nottingham stated in his testimony, the railroad industry has a direct and profound impact on our entire economy, since the goods moved by the freight rail industry are critical to the economic well-being of our entire nation. Therefore, railroads must invest prudently in order to meet future demand.

#### **Our Business**

At CSX, we strive to be the most progressive North American railroad. We are improving faster than the rest of the excellent freight rail industry on nearly every measure, including safety, customer service, and financial performance. We now rank among the industry's best companies in safety, service and corporate governance. Our

35,000 employees' efforts have made tremendous strides in meeting customers' needs and creating significant value for all CSX shareholders.

We have a balanced and disciplined plan to invest for the future of our rail network – to add additional capacity, newer equipment and technology, and improved transportation infrastructure and security. CSX operates 21,000 miles of track serving 23 states and the District of Columbia, and we are investing to meet the heightened demands of our customers and our economy in the years ahead, while continuing to provide exceptional returns to our shareholders.

Our company connects to 70 ocean, lake and river ports, and more than 230 short-line and regional railroads. CSX services 36 automobile distribution centers, 165 bulk intermodal terminals and rail-to-truck transload facilities, 130 active coal mines, and 105 coal-fired power plants and cogeneration facilities.

We serve virtually every major industrial and population center east of the Mississippi river with an average of 1200 trains per day. These trains carry everything from coal that creates energy to heat our homes, to the fertilizer that feeds America's harvest, to the orange juice we drink with our breakfast. There are four principal segments of our transportation business: 1) coal, coke and iron ore; 2) automotive; 3) general merchandise; and 4) intermodal, which involves freight that moves between rail, trucks and ships.

In 2007, CSX delivered 1.9 million carloads of coal, coke and iron ore, accounting for 26 percent of the company's revenue. Eighty percent of that coal is used for domestic energy production. That same year, CSX also delivered 439,000 carloads of finished autos and auto parts to the 19 vehicle assembly plants and distribution centers we currently serve. Three new auto plants scheduled to open by 2010 will be served by CSX as well.

CSX also transports general merchandise such as phosphates and fertilizers, chemicals, forest products and paper, metals, food, and other consumer products that earned our company \$5 billion in revenue in 2007. Our intermodal service combines the long-haul advantages of rail with the flexibility of trucking. CSX's 40 Intermodal facilities serve every major market east of the Mississippi.

We also serve more specialized customers, like the United States military. CSX carries the equipment and supplies our military needs to deploy efficiently and keep America secure. In 2007, our company moved more than 9500 carloads of vehicles, tanks and armaments – from Fort Drum in New York, the Letterkenny Army Depot in Pennsylvania, Fort Campbell and the Bluegrass Army Depot in Kentucky, Fort Eustis in Virginia, and Fort Stewart in Georgia – to interchange points with western railroads and East coast ports in Florida, the Carolinas and Philadelphia. From these ports, equipment and supplies are shipped to the men and women protecting our nation around the world.

#### The Benefits of Freight Rail to Our Nation

In our global economy, where the distance between the producer and the consumer is longer than ever, freight rail provides a timely, cost-effective, environmentally-friendly and safe mode of transportation. For this reason, more and more customers are turning to railroads – including CSX – to meet their transportation needs.

At a time when crude oil has passed the \$100 per-barrel threshold, freight rail is a cost-effective transportation solution that enhances our energy security and reduces our dependence on foreign oil. A typical CSX freight train delivers the equivalent of 240 truckloads, with dramatically lower fuel consumption. That not only reduces traffic congestion; it saves fuel for everyone. In fact, with increasing fuel efficiency CSX can now move a ton of freight 436 miles on a single gallon of fuel.

CSX also helps to relieve congestion on the roads and highways by providing critical infrastructure that is relied upon by more passenger and commuter rail networks than any other railroad. Though we are a freight railroad, 17.4 million passengers travel over CSX track each year on Amtrak and commuter railroads.

For our company, these environmental and commuter benefits are just the beginning. Since 1980, we have taken steps to improve our fuel efficiency by 73 percent.

And in the past five years, our subsidiary, CSX Transportation, Inc. (CSXT), has invested more than \$1 billion to upgrade its fleet with more efficient, low-emission locomotives.

I am proud that in March 2007, CSX became the first Class I freight railroad to join the Environmental Protection Agency's Climate Leaders program, pledging to annually inventory and publicly report its greenhouse gas emissions and establish a voluntary goal for reducing them. And just last month, our company also became the first North American railroad to launch a "carbon calculator," an online tool available at www.CSX.com that lets anyone compare the greenhouse gas emissions savings when freight is shipped on CSX, rather than by truck.

These initiatives aren't just good for our environment, they help build our business. When we save money by running our railroad in a more fuel efficient fashion, we can reinvest those resources in capital improvements that help us better serve our customers.

#### **Our Commitment to Safety**

When our railroad is operated efficiently and effectively, it also operates safely. At CSX, we have invested in and created a safety culture that has driven across-the-board improvement in safety. This investment made 2007 the safest year in our railroad's history. Since 2004, CSX has achieved a decrease in personal injuries of nearly 50 percent, an industry leading improvement. Over the past three years, CSX has reduced

train accidents by 42 percent – also an industry leading improvement. Our ultimate goal is zero accidents. Not only do we want to do better, regulators expect us to do better.

As Federal Railroad Administrator Joe Boardman noted in a January 3, 2008 statement, "[CSX] must stay focused, and not be distracted from making the necessary long-term investments in infrastructure, technology and employees that will strengthen its safety culture and performance."

CSX has pioneered unique safety and security partnerships with state governments to help protect and secure the communities where we do business. CSX has reached agreements with the states of Kentucky, Maryland, New Jersey and New York to share a proprietary CSX technology developed by our company that provides state emergency management officials and first-responders with immediate access to information about the locations of our trains and the contents of railcars under our control, including hazardous material shipments. CSX is also the only railroad currently sharing this security information with the Department of Homeland Security's Transportation Security Operations Center (TSOC), and we are working to enter similar arrangements with other states as well.

#### **Strong Operating and Financial Performance**

It's not a coincidence that our improvements in safety and security closely track improvements in operating performance. CSX led North American railroads in train

velocity and dwell improvement over the past three years, and CSX operational improvements over that period were driven, in part, by strategic capital investments in the network. For example, the capacity expansion projects that CSX completed in 2006 improved velocity on the coal route to power plants in the South by 40 percent and on the critical corridor from Chicago to Jacksonville by 14 percent in the following year. Operating performance improvements such as these have benefited our customers, our employees and our shareholders, but they would not be possible without continued investment in our infrastructure.

Since 2004, CSX operating income has nearly doubled, and our surface transportation operating ratio has improved to its best level in a decade – 76.4 percent for the fourth quarter of 2007. Operating ratio, which is inverse margin or the ratio of operating expenses to operating revenues expressed as a percentage, is a widely used performance measurement in the railroad industry.

As CSX performance has improved, shareholders have been rewarded. The value of CSX's stock has improved more than 150 percent in the last three years, which has provided shareholders with a return better than the rest of North America's Class I railroads and 94 percent of all Standard & Poor's 500 (S&P 500) companies

In the third and fourth quarters of 2007 CSX delivered exceptionally strong financial performance in the face of increasing economic uncertainty. In 2007, our

surface transportation revenue exceeded \$10 billion for the first time and our operating income increased to \$2.2 billion, a 14 percent increase over 2006 levels.

This improvement in operating performance and shareholder value has been driven by a six-person CSX senior management team with more than a century of combined railroad experience, and overseen by our Board of Directors, executing a balanced plan that has resulted in share repurchases and disciplined capital expenditures while meeting – and exceeding – the expectations of our stakeholders.

Returning capital to our shareholders through dividends and share repurchases is a key part of our long-term financial plan. Through the fourth quarter of 2007, CSX repurchased more than \$2.1 billion of its common stock – almost 50 million shares – as part of its current \$3 billion share repurchase program, which we plan to continue through 2008. Further, since 2005, the company's quarterly dividend has tripled. Returning capital to our shareholders through dividends and share repurchases is a key part of our long-term plan to create further value.

At the same time, we have invested more than \$4 billion of capital in our network in the last three years to meet heightened demand, and we intend to increase investment to nearly \$5 billion over the next three years to continue to meet that demand. This capital expenditure plan will also create jobs, increase value for our customers and shareholders and strengthen our nation's economy.

A significant percentage of that capital investment goes to pioneering technology initiatives that make our railroad run both more efficiently and more safely. For example, CSX has already installed Event Recorder Automated Download (ERAD) systems on 1500 locomotives, and by the end of 2009, CSX will have ERAD installed on 3000 locomotives. The ERAD system uses state-of-the-art WiFi technology to capture data from locomotive onboard computers as they pass through terminals, and CSX uses that data to improve train handling and increase fuel efficiency. Initiatives such as ERAD and NOWS place CSX at the forefront of railroad technology advances.

#### **Recognized Corporate Governance Leader**

At CSX, one of our core values is "right results the right way." While we are pleased with our record of improving operational performance and creating shareholder value, we are equally proud of the corporate governance structure that allowed us to achieve these results. As of January 18, 2008, CSX has a Corporate Governance Quotient (CGQ®) that is better than 92.6 percent of S&P 500 companies, and 98 percent of transportation companies. That ranking reflects the depth and breadth of corporate governance policies in place at the company, which include:

- Election of the entire board annually;
- Majority vote election of the board in uncontested elections;

- Majority vote (as opposed to supermajority vote allowable under Virginia law) on major events impacting shareholders such as charter amendments and mergers;
- Presiding independent director;
- No poison pill; and
- A limit on senior executive severance payments.

The improvements that CSX's Board of Directors, its management and its 35,000 employees have made over the last four years have allowed us to reward our shareholders, improve customer service, meet the needs of passenger and commuter rail agencies, and do so in a safe, secure, and environmentally responsible fashion that is consistent with the highest standards of corporate governance.

But our company's management, its employees and its Board of Directors believe we can achieve much more. By 2010, our goal is to reach an operating ratio in the low-to-mid 70's, through a combination of service improvements and productivity initiatives, which will allow the company to continue to capture greater value from its transportation businesses. We want more emerging markets to look to freight rail – and to CSX – to meet their transportation needs, and we want to continue to improve on safety.

Today, however, all of these achievements and aspirations are put at risk.

#### Our National Rail Infrastructure Requires Ongoing Investment

As a publicly traded company, CSX must balance the interests of all of its stakeholders. Above all else, we must continue to create value for our shareholders – both in the near and long term – but the interests of some hedge funds who have invested in our company and our industry are not aligned with long-term shareholder interests or the interests of our other constituencies. These hedge funds seek to satisfy their short-term investment horizon by pushing policies that will have long-term detrimental implications for our shareholders, our customers and the rail industry.

At CSX, we believe that to continue to deliver safety and service improvements while meeting the vital transportation needs of our country, we must continue to invest for the future. But our investment plan has been challenged by a group of hedge funds that has purchased a significant stake in CSX, and in other Class I railroads as well.

We know little about these funds, except that two foreign hedge funds organized in the Cayman Islands – The Children's Investment Fund (TCI) and 3G – claim to have together purchased a 20.1 percent economic interest in our company (8.3 percent in actual share ownership, and 11.8 percent in derivative interests that had not been previously disclosed in public filings) and announced this position in a joint news release. You may be surprised that such a large foreign investment in our company does not trigger an automatic review by the Committee on Foreign Investment in the United States

(CFIUS), or, further, that these foreign hedge funds are largely unregulated and beyond the reach of Federal oversight.

The most vocal and active of these funds, (TCI) has made a variety of requests in its many public statements, letters and meetings with CSX leadership over the last 13 months. TCI has called for a number of short-term strategies – including freezing investments in infrastructure expansion, doubling customer rates over the next decade, doing a leveraged buyout, and more than doubling CSX's debt and reducing our credit rating to junk status.

Such actions might permit hedge funds like TCI to turn a quick profit, but over the long term could limit our ability to invest in critical rail infrastructure and be harmful to our shareholders, customers, and all those who rely on a safe, secure and well maintained CSX rail network.

#### **Labor Concerns**

Three of the labor unions that represent CSX locomotive engineers, maintenance-of-way and other transportation employees have expressed substantial concerns about TCI's plans for our company. A few of their concerns are excerpted below:

From the Brotherhood of Maintenance of Way Employees Division (BMWED):

TCI began this dispute with a letter to the CSX Board of Directors saying, among other things, that "relations with labor . . . are strained." While BMWED has its share of disagreements with CSX management, no one from TCI contacted BMWED to find out our opinion on labor relations. If TCI is willing to make accusations about labor relations without talking to labor, what else have they alleged without foundation?

#### From the Brotherhood of Locomotive Engineers and Trainmen:

The industry has also attracted aggressive hedge fund investors, such as The Children's Investment Fund, or TCI. These hedge fund investors are typically out for only one thing — money for shareholders. They're out to earn money for investors, sometimes at the expense of the company in which they invest.

# From The Transportation Communications International Union (TCU):

If past actions by the hedge fund are any guide, employees too would suffer as a result of their single-minded drive to increase stock prices.

TCI previously invested in ABN Amro, a Dutch bank with worldwide locations. They broke the bank up – investors profited, while 550 ABN Amro employees in Jacksonville, Florida lost their jobs.

Finally, let me highlight CSX's position on the need for our nation's railroads to invest for the future:

- 1) Expansion Capacity. Anyone who understands the rail industry indeed, the transportation network as a whole knows that we need to maintain and even increase our investments where possible to prepare for future demands for our service. In order to continue to move coal from the mines of West Virginia, juice from orange groves in Florida, ethanol from the heartland of our nation, and armaments for our military, our company has a strategic capital spending plan to upgrade its existing track, ties, bridges, and signals, add track to improve our network and better serve our customers your constituents over the long-term. If our nation's railroads reduce capital spending and cease investing for the long-term due to pressure from hedge funds or for other reasons our rail network would suffer, resulting in service deterioration and impaired on-time performance.
- 2) Passenger Service. CSX tracks carry more Amtrak and commuter trains than any other North American railroad. Investing less money in our network would mean less ability to serve the future needs of communities that want to alleviate highway congestion by turning to commuter rail, and could have significant adverse consequences for Amtrak operations as well as commuter operations in Virginia, Maryland, Florida, Massachusetts and elsewhere.

- 3) Military Transportation. CSX is critical to the timely deployment of the United States Armed Forces. Compromising our rail network would undermine our ability to carry the goods that the military needs to deploy efficiently and keep America secure.
- 4) Environment. Limiting investment in the railroads would also pose a real threat to our nation's environment. This Subcommittee is all too aware of concerns over climate change, the States' compliance with tougher clean air standards, and high energy prices. With continuing investment, CSX stands ready to meet our nation's rapidly-growing freight demands while addressing these important concerns. In order for CSX to continue to offer the most environmentally-friendly and energy-efficient way to move goods on land, we must invest in: 1) newer and cleaner locomotives; 2) fuel efficiency technologies; and 3) network maintenance and expansion.
- 5) Safety and Security. When it comes to safety, a newer and more efficient railroad is a safer and more secure railroad. Improving safety is not just about switches, handbrakes, and global positioning systems. It's about investing in employees (nearly one-in-five CSX employees is a veteran of our armed forces, a ratio we hope to increase) and infrastructure to create a safety culture that also allows us to better serve our customers. We intend to stay focused on enhancing both safety and security. A continued investment in operational safety and security is critical in the post 9-11 threat environment. The government has

designated CSX's rail network critical infrastructure that is vital to the nation's economic interest. We treat it as such, and invest millions every year to identify, guard against, and prevent threats from those who would do our nation harm.

In conclusion, Madam Chairwoman, on behalf of CSX's Board of Directors, its management and its employees, I want to express my appreciation to you and members of the Subcommittee for highlighting this important issue. I also thank you for your recognition that while increased investment in the railroad industry is a positive development, our company's responsibility to its investors must be balanced with our commitment to our employees, our customers, the communities we serve, and, most certainly, our role in helping this country achieve its public policy objectives.

18